



MIAMI BEACH

OFFICE OF THE CITY MANAGER

NO. LTC # 290-2015

LETTER TO COMMISSION

TO: Mayor Philip Levine and Members of the City Commission

FROM: Jimmy Morales, City Manager

DATE: July 14, 2015

SUBJECT: **Standard & Poor's and Moody's Rating on the City of Miami Beach, Florida Stormwater Revenue Bonds, Series 2015**

The purpose of this Letter to Commission is to advise you of the results of a credit review done by Standard and Poor's (S&P) and Moody's, on the City's Stormwater Revenue Bonds, Series 2015 (the "Bonds").

While both agencies affirmed our current ratings, both had comments about the amount of additional debt needed for the capital program during the outlook period. Although S&P gave us a stable outlook and Moody's gave us a negative outlook, both set expectations that to issue the additional proposed debt we must make timely rate increases, increase coverage beyond current levels and maintain liquidity in order to maintain our ratings going forward.

Standard & Poors

S&P has assigned a rating of AA- and a stable outlook to the Bonds and has also affirmed the rating of AA- on the City's outstanding Stormwater Bonds Series 2009 and 2011A and B.

S&P's AA- rating is based on (1) historically positive financial results, strong revenue collections that produce good coverage and liquidity levels, (2) rate autonomy with a willingness to increase rates and (3) reserves targeted to cover at least two months of operations.

The stable outlook reflects the expectation that the City will increase rates as necessary to address the system's large CIP while maintaining strong coverage and liquidity levels. However, S & P points out that the ability to increase the system's rating in the current outlook period is limited due to capital needs and their impact on the utility's financial status. Further, that a reduction in rating could be caused by deterioration of the utility's financial position resulting from additional debt and capital needs during the outlook period.

Moody's

Moody's has assigned a rating of Aa3 and a negative outlook to the City's Stormwater Revenue Bonds, Series 2015. They have also affirmed the Aa3 rating and assigned a negative outlook to the outstanding Stormwater Bonds Series 2009 and 2011A and B.

Moody's Aa3 rating is based on the stormwater system's healthy liquidity position, strong cash reserves, adequate debt service coverage, mature service area and high leverage.

The Moody's negative outlook reflects the stormwater system's expectation of significant additional debt in the near term which will increase the system's already high leverage and require additional rate increases.

Moody's indicates that to remove the negative outlook, the City would need to significantly increase its debt service coverage. Although the City is meeting its legal coverage requirements under the Bond Resolution, its coverage is relatively less than other credits in the Aa3 category. This means that instead of maintaining the required 110% coverage, or the 120% coverage currently used for rate setting, we would need to maintain coverage in excess of the 135% level and set rates to reflect this. Additionally, Moody's also indicates we could improve the outlook by not issuing additional debt.

Further, Moody's cautioned that Aa3 rating could be reduced by the issuance of additional debt without timely rate increases, reductions in debt service coverage or significant declines in liquidity.

The \$90 million Stormwater Revenue Bond Series 2015 which will provide \$100 million in proceeds is scheduled to be priced in the market in late July 2015 and close in early August 2015.

If you have any questions or need additional information, please feel free to contact me.

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns negative outlook to Miami Beach, FL's Stormwater Revenue Bonds

Global Credit Research - 10 Jul 2015

Aa3 assigned to \$90M Series 2015 bonds

MIAMI BEACH (CITY OF) FL STORMWATER ENTERPRISE
Storm Water Enterprise
FL

Moody's Rating

ISSUE

RATING

Stormwater Revenue Bonds, Series 2015

Aa3

Sale Amount \$90,000,000

Expected Sale Date 07/21/15

Rating Description Revenue: Government Enterprise

Moody's Outlook NEG

NEW YORK, July 10, 2015 --Moody's Investors Service has assigned a Aa3 rating and negative outlook to the City of Miami Beach's (FL) \$90 million Stormwater Revenue Bonds, Series 2015. At this time, Moody's also affirmed the Aa3 rating and assigned a negative outlook to \$90 million in outstanding parity bonds.

SUMMARY RATING RATIONALE

The Aa3 rating is based on the system's healthy liquidity position, adequate debt service coverage, mature service area and high leverage.

OUTLOOK

The negative outlook reflects the system's expectation of significant additional debt in the near term which will increase its already high leverage and require large additional rate increases.

WHAT COULD MAKE THE RATING GO UP (removal of negative outlook)

-Significant increase in debt service coverage

-No further increase in debt burden

WHAT COULD MAKE THE RATING GO DOWN

-Additional debt without timely rate increases

-Weakened debt service coverage

-Significant declines in liquidity

STRENGTHS

-Strong cash reserves

-Adequate debt service coverage

CHALLENGES

-Very high debt burden with additional debt expected

-Weak legal covenants

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale section.

DETAILED RATING RATIONALE

SERVICE AREA AND SYSTEM CHARACTERISTICS: MATURE SYSTEM ON BARRIER ISLAND SUSCEPTIBLE TO FLOODING, HURRICANE RISKS

The stormwater system's service area covers a large 4,200 acres and extends beyond Miami Beach, including adjacent islands. Miami Beach is one of 33 municipalities that is a co-permittee with Miami-Dade County through the National Pollutant Discharge Elimination System. The current permit expires June 20, 2016 (they are typically awarded for four-year periods) and the system is in compliance with all relevant regulatory bodies. Notably, as a barrier island, the city is subject to greater stormwater needs than most US stormwater systems. A significant portion of the system lies at an elevation below 2.2-feet. The city's projections include rising sea levels and the capital plan addresses related needs.

The stormwater fee is imposed on properties based on Equivalent Residential Units (ERUs) which currently stands at 109,000 ERUs, representing a population base of 87,779 according to the 2010 Census. The customer base is expected to remain stable in this mature, tourism dependent service area. The stormwater fee is billed as part of the water, sewer and garbage bill and collection rates have historically been high.

DEBT SERVICE COVERAGE AND LIQUIDITY: ADEQUATE DEBT SERVICE COVERAGE MITIGATED BY STRONG LIQUIDITY

The stormwater system will likely maintain adequate financial operations given healthy liquidity and a history of timely rate increases. Management has typically increased rates prior to significant debt issuances, including a substantial 84% increase in fiscal 2015 which increased rates to \$16.67 per ERU from \$9.06. The average in Florida is \$5.68, however, this includes inland communities with less vulnerability to storms and flooding. Current projections include additional rate increases in 2017 and 2019 of 38% and 19%, respectively, prior to debt issuances in those years.

Debt service coverage has historically been adequate. In fiscal 2014 coverage was 1.66 times, including a transfer from the Rate Stabilization Fund of \$1.8 million. Without this transfer, coverage was a still-satisfactory 1.34 times. Management does not anticipate utilizing the Rate Stabilization Fund (\$5.7 million at fiscal 2014 year-end) in 2015 due to the rate increase. Moody's calculates debt service coverage net of an annual payment to the city (\$435,000 in fiscal 2014) for administrative purposes, which legally comes after debt service requirements, and net of the system's annual interest earnings from the outstanding bond proceeds, as those earnings are restricted for the capital projects financed through the bond issuance. Coverage is projected to increase to 2.34 times in 2015 again due to the rate increase, but decline to 1.34 times in 2016 once debt service payments on the Series 2015 bonds begin. Debt service from 2016 through 2020 is projected between 1.29 and 1.35 times. This coverage level is relatively weak for the Aa3 rating category, and therefore any inability to maintain coverage at these levels as additional debt is issued could pressure the rating.

Liquidity

Fiscal 2014 ended with \$11 million in unrestricted cash and investments or a strong 1,083 days cash on hand. Additionally, the system maintains \$5.7 million in a Rate Stabilization fund. These rate stabilization funds are restricted by designation by the city commission, which can release them as needed. Projections indicate that the fund will grow over the forecast period; the system's ability to maintain adequate liquidity is necessary for maintenance of credit health, as it is an offset to the only-satisfactory debt service coverage.

DEBT AND LEGAL COVENANTS: HIGHLY LEVERAGED SYSTEM WITH ADDITIONAL DEBT EXPECTED

The system is highly leveraged and the capital plan includes significant additional debt. The system's debt will virtually double with the current issuance and another \$200 million is anticipated within the five year capital plan for various projects, including conversion to a pump system from a gravity fed system to address the city's projections of rising sea levels. The system's capital plan includes \$432 million of projects, which management expects to address over the next 10 years.

The debt ratio was an average 47.6% in fiscal 2014, which will increase significantly with the current issuance and then decline moderately as the proceeds are reinvested into the system. Debt to operating ratio was a high 7.7 times in fiscal 2014 and projections indicate growth to 8.8 times in fiscal 2015. The projection factors in the current issuance and the increased revenues that will be generated from the rate increase. Both the debt ratio and debt to operating ratio are likely to rise further in the near term with additional debt issuance beyond this series, although these measures will be somewhat offset by reinvestment into the system (debt ratio) and increased revenues from rate increases (debt to operating revenues).

Legal provisions are weak with a rate covenant of 1.1 times annual senior lien debt service; an additional bonds test requiring net revenues for any 12 of the 18 preceding months to be 1.1 times MADS on the current and proposed bonds or 1.1 times MADS on the current and proposed bonds for the future in order to issue parity debt. The flow of funds is liberal in that it allows an open loop structure whereby the system can, and does, transfer funds to the city's General Fund. There is no debt service reserve fund for the current issuance or the 2009 bonds. The 2011 bonds have a debt service reserve funded at MADS.

Debt Structure

All the system's debt is fixed rate.

Debt-Related Derivatives

The system has no exposure to derivatives.

MANAGEMENT AND GOVERNANCE:

System management is generally strong and has the legal ability to raise rates without third party approval. The utility has independent rate-setting authority. Management is generally conservative in its projections and budgets for a 1.2 times rate covenant annually. Positively, management has implemented significant rate increases prior to additional debt issuance. Any inability to pass future rate increases as additional debt is issued will pressure the rating.

KEY STATISTICS

- Asset condition: 61 years of remaining life for capital assets
- System size: \$3.7 million of operating expenses
- Median family income, 2012 American Community Survey: 82.7% of U.S.
- Annual debt service coverage, FY2014: 1.34 times (excluding Rate Stabilization Fund)
- Cash on hand, FY2014: 1,083 days of operating expenses
- Debt to Operating Revenues: 7.7 times
- Rate covenant: 1.1 times
- Debt service reserve requirement: None

OBLIGOR PROFILE

City of Miami Beach Stormwater system covers 4,200 acres and services 109,000 ERUs. Miami Beach had a population of 91,026 in 2014.

LEGAL SECURITY

The bonds are secured by the net revenue of the stormwater system.

USE OF PROCEEDS

Proceeds will be used to convert portions of the system from a gravity fed system to a pump system.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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RatingsDirect®

Summary:

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Rationale

Outlook

Related Criteria And Research

Summary:

Miami Beach, Florida; Water/Sewer

Credit Profile

US\$90.0 mil stormwtr rev bnds ser 2015

Long Term Rating

AA-/Stable

New

Miami Beach stormwtr rev bnds

Long Term Rating

AA-/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating, and stable outlook, to the City of Miami Beach, Fla.'s series 2015 stormwater revenue bonds. At the same time, we have affirmed the rating on the city's outstanding stormwater bonds.

The rating reflects what we view as the city's, and the stormwater system's:

- Location and role in the deep and diverse Miami metropolitan statistical area (MSA);
- Historically positive financial results, with a high degree of revenue certainty that produces good coverage and liquidity levels; and
- Rate autonomy and willingness to increase rates.

The utility's regulatory-driven capital program, which will require a significant amount of additional debt, coupled with large increases in drainage fees to maintain current financial margins, somewhat offset these strengths.

The stormwater utility's net revenues secure the bonds. We understand that bond proceeds for the 2015 bonds will finance various capital improvements as part of the long-term capital plan. Miami Beach serves an estimated population of about 91,000 in Dade County and is located across Biscayne Bay from Miami. Income levels in the city are adequate, in our opinion, with median household effective buying income at 75% of national levels. Miami Beach's stormwater utility system serves about 109,000 equivalent residential units (ERUs). The customer base has been stable. The city's revised capital improvement plan (CIP) totals more than \$400 million for the next five years. Management has represented that the CIP will be funded primarily through additional debt issuance.

Management has autonomy to review and set rates. Current rates of \$16.67 per monthly ERU were increased at the beginning of fiscal 2014, and reflect an 84% increase from the prior rate. Additional increases of 36% and 23% are planned for fiscal 2017 and fiscal 2019, respectively. In the past five years, operating revenues have remained very stable, hovering between \$11.2 million and \$11.7 million. Offset by operating expenditures, the result has been net revenues available for debt service ranging from \$7.7 million to \$8.6 million. This produced annual debt service coverage (DSC) ratios of 1.4x to 4.0x, though the last two fiscal year results have been at the 1.4x level. Following this issuance, the annual required debt service payment will increase from the current fiscal 2015 level of \$6.8 million to \$11.9 million. With the implementation of the large CIP, and the issuance of additional debt, the debt service payment

is projected to increase to \$25.0 million by 2020. Based on the city's current projections, and incorporating these rate increases, management projects annual DSC to range between 1.2x and 1.7x.

In our opinion, liquidity levels have remained strong, with fiscal 2014 ending with unrestricted cash and investments totaling \$11.0 million. Management targets to maintain reserves to cover at least two months of operations. In addition to the unrestricted amounts, there was an additional \$5.7 million available at the end of last year. While the majority of the CIP will be funded with bond proceeds, some use of reserves is likely to support pay-as-you-go projects.

Outlook

The stable outlook reflects our expectation that management will increase rates as necessary to address the system's large CIP while maintaining good coverage and liquidity levels. Upward rating mobility is limited in the current outlook period due to capital needs that must be addressed and their impact on the utility's financial profile. Downward rating pressure would result if the utility's financial position significantly deteriorated due to additional debt and capital needs during the current outlook period.

Related Criteria And Research

Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

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